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TO RUEHC/SECSTATE WASHDC IMMEDIATE 9425
INFO RUEHEE/ARAB LEAGUE COLLECTIVE IMMEDIATE
RUCNMEM/EU MEMBER STATES COLLECTIVE IMMEDIATE
RUEHTV/AMEMBASSY TEL AVIV IMMEDIATE 1052
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C O N F I D E N T I A L SECTION 01 OF 02 DAMASCUS 002632

SIPDIS

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NEA/ELA
TREASURY FOR GLASER/SZUBIN/LOEFLER
NSC FOR POUNDS/SINGH

E.O. 12958: DECL: 06/01/2016

TAGS: ECON EFIN EINV SY

SUBJECT: NON-PERFORMING LOANS IN THE PUBLIC BANKS- ANOTHER
ECONOMIC WEAKNESS

REF: A. DMS 1696

¶B. DMS 2504

Classified By: Charge d'Affaires Stephen Seche, reasons 1.4 b/d

¶11. (C) Summary: The SARG's public banking sector is hamstrung due to the fact that its six public banks are carrying a large number of non-performing loans. Contacts suggest that many of the loans may be held by the SARG, which borrows from the banks to finance public spending, or lost to the corruption of regime officials. While the SARG is said to be considering an audit to determine the true size of the problem, it lacks the tools to resolve the issue without structural change, and contacts worry that the problem is growing due to a recent upsurge in public sector lending.
End summary.

¶12. (C) Contacts involved in the banking and financial sectors state that Syria's six public banks are carrying a sizable portfolio of non-performing loans, which some have estimated may comprise as much as 50% of the public sector's lending. Contacts suggest that the banks with the worst lending rate are the Popular Credit, Industrial, and Agricultural banks, as well as the Commercial Bank of Syria (CBS). Adding to the potentially destabilizing number of non-performing loans, contacts state that there was a 40-45% expansion in credit from the public banks during 2005, particularly from the Popular Credit and Real Estate banks. The size of the public sector lending also was noted during a recent visit by an International Monetary Fund (IMF) delegation.

¶13. (C) There currently is no publicly available information on the recipients of the loans or the dollar value of those that are non-performing, contacts contend. The banks have not been audited according to international standards for years. A contact at the European Investment Bank (EIB), which is funding capacity-building programs for the public banks and the Central Bank, stated, for instance, that the Central Bank has not been audited by Syria's own Central Organization for Financial Control since the 1970's. Contacts indicate that the public banks suffer from abysmal management and accounting practices through isolation from the international financial system since the SARG nationalized its banking sector in 1965.

¶14. (C) Despite the lack of reliable statistics or lending records, contacts state that the SARG may hold a large portion of the non-performing loans, since public banks are

forced to cover subsidy spending and annual budget deficits. Contacts report that the Agricultural Bank covers the cost of price supports for cotton production, for which the SARG has no budget line item (ref A). The CBS also allegedly has made a significant number of loans to the Office of Cotton and Wheat that have not been repaid, but continue to show up on the bank's balance sheet as assets. The Real Estate Bank faces a similar problem, contacts report, due to its financial support of housing cooperatives and the General Organization for Housing. In addition to its public sector lending, contacts say that the Agricultural Bank has a high default rate on its many small loans to farmers, who can receive up to \$2,000 a year in fertilizer or seed against their expected harvest. Contacts say that the bank has no mechanism to collect on the loans except through public sector organizations that have been established to purchase each particular crop, which farmers allegedly avoid by selling their crops to middlemen for cash.

¶ 15. (C) Contacts also contend that many of the outstanding non-performing loans resulted from corruption, through which government officials and those with close ties to the regime have been able to amass fortunes despite their low public salaries. In one of its occasional and cosmetic attempts to combat corruption, the SARG arrested the former head of the CBS, Mahmoud Nadim Methqal, in 2002 for transferring millions of dollars into a foreign bank account. More recently, the Minister of Finance fired the Director General of the Industrial Bank, Ali Kanaan, at the end of 2005 for financial misconduct. Problematically, contacts say that loans from the Industrial Bank increased tenfold during his tenure. Walid Abdel Nour, General Manager of Byblos Bank, which recently entered into a partnership with the CBS and the EIB to provide loans to small and medium-sized enterprises (SME),

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stated that the CBS long has made its project loans based on the influence and contacts of the recipient as opposed to the quality of the project. He said that he already has received two SME project files from the CBS that contained no risk or project analysis, forcing his staff to start the application process over again from scratch.

¶ 16. (C) Contacts report that the SARG is aware of the problem and is considering options of how to proceed. The EIB and European Commission (EC) are recommending that the Ministry of Finance conduct an audit to determine the financial position of the public banks. Contacts at the EC Mission state that the Ministry of Finance is expected to make its decision regarding the audit by mid-June. Other contacts suspect that the SARG may be unwilling to submit to an audit conducted according to international standards because of the political risks that it would disclose weaknesses in the SARG's fiscal position and uncover corruption among its officials. Contacts further state that the SARG presently has no tools to deal with the problem even if an audit is completed. There is no institution that could securitize the bad loans, and no bond market through which the government could finance the recapitalization of the banks. Although some contacts suggest that the Central Bank is the most logical institution to assume responsibility for the non-performing loans, most independent Syrian economists and bankers state that the Central Bank suffers from its own mismanagement and would be incapable of taking on a role of this complexity (ref B).

¶ 17. (C) Comment: The potential number of non-performing loans that were issued to finance the SARG's deficits and subsidies belies regime claims that the SARG's short-term fiscal position is sound. In addition, if the estimates are true that half of the banks' loans are non-performing, then the SARG faces a potential crisis in its public banking sector for which it lacks the tools to manage in any effective way. The issue is one that the SARG ignores at its own risk. Even though the costs of exposing the corruption that has weakened the banks will grow with time, it seems doubtful that the

SARG will move decisively to address this problem until the
contaminant economic costs of continued inaction compel it to
do so.

SECHE